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No. 75

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1964.

COLORADO INTERSTATE GAS COMPANY,
a Corporation,
Appellant,

vs.

THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, SOUTHWEST KANSAS ROYALTY OWNERS ASSOCIATION AND PANHANDLE EASTERN PIPE LINE COMPANY,
Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF KANSAS.

REPLY TO MEMORANDUM FOR THE FEDERAL POWER COMMISSION

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It would appear that we have an added burden. The very federal agency that should be concerned with the federal functions under the commerce clause and the Natural Gas Act signifies in its Memorandum filed herein

that there is no substantial federal question involved in our appeals. Our adversaries pitched the main thrust of their motions on the premise that the decisions below rested on adequate non-federal grounds. In our brief opposing Appellees' motions we demonstrated that the Kansas Supreme Court directly recognized and inescapably determined our posed federal questions.

Herein we will demonstrate, this time with particular attention to the Federal Power Commission's Memorandum, that the federal questions we raise are present and are substantial.

We are not here urging that this Court demolish state conservation and proration. We do urge that this Court make it very clear that the states must stay within recognized concepts of conservation and proration. The instant orders just do not fall within the recognized ambit of legitimate state function. They are concerned with volumes of gas sold; they are not concerned with conservation, but rather with exploitation. They represent an attempt, in an effort to obtain a greater share of the national consumer demand for gas, to license one pipe line purchaser to divert reserves dedicated to one consumer market under Federal Power Commission certificates, to another consumer market.

No state under our Constitution can determine for itself what share of the consumptive demand for gas in all the states should be served by the sources of supply in that particular state. Obviously, if this were not so each state would serve its own selfish ends to the detriment of the whole of these United States. It simply is not an area where the states can practicably regulate. Therefore, the federal Constitution and laws must prevail and the instant state orders must fail. Our appeals fall directly

within the principle expounded by this Court in *Federal Power Commission* v. *Transcontinental Gas Pipe Line Corporation*, 365 U.S. 1, 81 S.Ct. 435, 5 L.Ed.2d 377 (1961):

> "* * * Therefore, when a dispute arises over whether a given transaction is within the scope of federal or state regulatory authority, we are not inclined to approach the problem negatively, thus raising the possibility that a 'no man's land' will be created. Compare Guss v. Utah Labor Relations Board, 353 U.S. 1, 1 L.Ed.2d 601, 77 S.Ct. 598, 609. That is to say, in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs." (365 U.S. at 19-20).

Actually, instant orders are merely another tack of the grasp for dollars for local interests exhibited by the Kansas Corporation Commission, beginning with its unsuccessful attempt to fix prices, as in *Cities Service Gas Company* v. *State Corporation Commission*, 355 U.S. 391, 78 S.Ct. 381, 2 L.Ed.2d 355 (1958), and extending to its ill-fated try at requiring purchasers to purchase ratably, as in *Northern Natural Gas Company* v. *State Corporation Commission*, 372 U.S. 84, 83 S.Ct. 646, 9 L.Ed.2d 601 (1963). Here the thrust of the orders from which we appeal is with volumes of gas, with the market for gas, and stated most succinctly with the avowed purpose of the Commission to obtain greater runs of the Kansas Hugoton gas to supply the national markets.

This is not the first time the Federal Power Commission has been dead wrong. At times its views have differred the whole 180° from the pronouncements of this Court, as in *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), and the views

expressed by the Federal Power Commission in its brief on the merits in the *Northern* case, *supra*. Equally important the views of the Federal Power Commission expressed in the Memorandum herein differ diametrically from those expressed by it before this court in *Transcontinental*, *supra*. There the Federal Power Commission carefully sought to protect the consuming public from higher prices which could and did obtain in a sellers' market. But in our appeals we have the anomaly of state orders which seek to and do create a sellers' market even though there is an excess of supply. Appellant, to protect its own reserves (if instant orders are to prevail), must purchase more Kansas Hugoton gas. Such orders place Appellant under most stringent economic compulsion. Its alternatives are to lose its reserves dedicated to its interstate markets or to purchase more Kansas Hugoton gas despite the disturbing effect on its purchasing patterns, the heating value of its gas, its plans and its facilities, all to the detriment of the ultimate consumer.

We will proceed to discuss the Federal Power Commission's Memorandum and will demonstrate that, regardless of the assertions therein, there are in our present appeals substantial federal questions which this Court should answer.

I.

In its Memorandum the Federal Power Commission first contends that the orders issued by the Kansas Corporation Commission which form the subject matter of our appeals are unlike the ratable take orders condemned by this Court in *Northern Natural Gas Company* v. *State Corporation Commission of Kansas*, 372 U.S. 84, in that the orders are directed at producers while the orders in the *Northern* case were directed at purchasers. Unless we

are to exalt form at the expense of substance, this contention has no merit. True, in *Northern* the purchasers were named, directed and affected by the orders. In the instant cases the orders are directed at and affect the purchasers. They have to be so directed and intended because otherwise the Kansas Corporation Commission's purposes could not be realized. No gas is produced which is not purchased. Does the mere naming of the purchaser as in *Northern* make a substantial federal question? Is the naming of the purchasers the sole operative jurisdictional fact? The direction of the orders, their impact, is the same—as the purchasers. This is inescapably true by the very nature of the orders and the inescapable facts of life of the business of obtaining gas and supplying it to consumers. The orders in the instant appeals determine the market demand, the amount of gas that should be purchased in the Kansas Hugoton Field. This is the concern of the purchasers. If any purchaser is not able to run through its interstate pipe lines the amount of gas which the other purchasers are running, it is the purchaser who loses a part of its reserve dedicated to its interstate market. To protect against such loss of reserves it is the purchaser which must change its purchasing patterns to enable it to safeguard its reserves in the Kansas Hugoton Field and not lose them to some other purchaser with a different consumer market. The impact of the orders is, therefore, inescapably on the purchasers. The orders are directed to the producers "and other interested parties having a right to withdraw gas." (Appendix to Colorado Interstate Gas Company's Jurisdictional Statement, p. 115.) The real parties in interest are the purchasers who are parties with a right to withdraw gas.

We have heretofore pointed out to this Court that the orders involved in the instant appeals were made by the Corporation Commission of Kansas as a result of joint dockets, the first dealing with the determination of market demand, *i.e.*, the amount of gas which such Commission felt should be purchased in the Kansas Hugoton Field, which notices were directed at both purchasers and producers. The response to such market demand notices has been traditionally (and must be practicably) made by the purchasers since they are the market for Kansas Hugoton Gas and are, therefore, the only ones who can supply the necessary estimates. The second dealt with Orders to Show Cause why the purchasers should not be required to take ratably from the various wells in the Kansas Hugoton Field.* These were directed at the purchasers alone, in an admitted effort, *i.e.*, admitted by the Commission, to obtain more purchases of Kansas Hugoton gas to achieve what such Commission felt was the fair share of the consumers' market for gas in the United States to be supplied from the Kansas Hugoton Field. The thrust of such orders was concerned inextricably with volumes of purchases. This Court is well aware that the jurisdiction of any state commission does not extend to prices or volumes of purchases and it is equally well aware that it must determine the impact of the orders and not whether they nominally relate to something else. If the impact of the orders relates to prices or volumes of purchases, it is outside the state ambit of authority. Thus this Court stated in *Northern*, supra, at 372 U.S. 90-91.

> "* * * But our inquiry is not at an end because the orders do not deal in terms with prices or volumes of purchases * * * The Natural Gas Act precludes not

*See Appendix to Colorado Interstate Gas Company's Jurisdictional Statement, pp. 120-123

> merely direct regulation by the States of such contractual matters. * * * The Congress enacted a comprehensive scheme of federal regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipe line company or not and whether occurring before, during, or after transmission by an interstate pipeline company'."

The substantial Federal questions herein involved do not relate to production and gathering, exempted under the Natural Gas Act. The activities which fall within such exemption have long since occurred before we reach the problems presented in these appeals. The producer, under his lease, had the right to explore for gas. He did explore and obtained gas and sold it under a long term purchase contract filed with the Federal Power Commission. After the connection of such well with such interstate pipe line purchaser, the producer's job was done, with the possible exception of reworking his well if it would not produce into the pipe line purchaser's line. Our concern is with the market demand, with the volume of gas to be purchased. It is the pipe line purchaser who supplies the market for the gas produced from such wells so obtained pursuant to leases. It must see to it that the correct amount of gas is introduced into the pipe line at its purchasing end to balance the gas sold at the other end of the pipe line where it is distributed to consumers. This Court in its *Northern* decision, 372 U.S. 92, made reference to shifting to the shoulders of the pipe line purchasers the burden of the balancing of the input. As a matter of fact, this burden is with the purchasing companies and has always been with the purchasing companies. The purchasing company must determine the amount of gas which is introduced into its lines and of course this amount must coincide with the gas it sells at wholesale at the other end of the line.

II.

In its memorandum the Federal Power Commission does recognize the facts as we set forth heretofore for this Court—the State Corporation Commission of Kansas has changed its method and its aim in the Kansas Hugoton Field.

Prior to the instant orders it allocated under a proration formula the amount of gas actually marketed, on an equitable basis to all the wells in the common source of supply, i.e., the Kansas Hugoton Field. In the instant orders before this Court on appeal, it has not allocated the actual gas marketed but has sought to tamper with the volumes to be purchased and has, therefore, allocated some fictitious figure greatly in excess of the actual gas marketed. This has caused huge underages to arise. The Federal Power Commission suggests, with an over-simplified illustration, that prior to the orders before this Court in the instant cases, the Commission used as its guide the amount of gas desired from the Kansas Hugoton Field by the pipe line purchaser with the least demand and contends that under the instant orders the Commission has merely changed the criterion to the pipe line purchaser with the greatest demand. Neither suggestion is correct.

Proration entails an equitable allocation of the market demand furnished by all the pipe line purchasers to all the wells in the common source of supply.* Whatever the demand is, in the aggregate, by the pipe line purchasers, such quantity is allocated under a proper proration formula to all the wells. This does not mean that any given pipe line purchaser can satisfy its demands from its own con-

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*This is market demand proration and the only type involved in these appeals. Other types, perhaps available, have not been tried by the Kansas Corporation Commission

nected wells since its demand may or may not coincide with the quantity of gas available from its own connections. It may be over-connected or under-connected. It does mean that its demands can be satisfied from the Field as a whole. If it desires more gas from the Field, it is available in the Field from some pipe line purchaser who is under-produced since its connections are greater than its demand. This is proration and has been so recognized by all the states which have passed gas conservation acts and has been recognized by this and other courts repeatedly.*

Proration (which is nothing more than an equitable allocation of the total demands of the market to all the wells in the common source of supply) works since a purchaser with a greater demand than the supply available from its own connections will find another purchaser with a demand less than the supply available from its connections. Thus we have a prospective purchaser and seller among the purchasers.

This can not obtain under the orders from which we appeal. The Kansas Corporation Commission has tampered with volumes of purchases and is allowing the purchaser

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*Thus, if A, B and C are pipe line purchasers, if A desires 30 units, while B and C desire only 15 units each, the aggregate desire for gas available to be produced is 60 units. If the connections of each of the pipe line purchasers are equal, each would be entitled to 20 units from the 60 units which are made available under a proration formula. If A produces his full allowable of 20 units and B and C produce only their demand of 15 units each, thus causing an under-production of 5 units each or 10 units in the aggregate, the 10 units will be subtracted from the next month's current allowable because the 10 units are already gas available to be produced. A can obtain his demand from the Field but not from his own connections. To obtain his desires under proration from the Field, A must deal with those companies who have an over-supply, i. e., with B and C

with the greatest demand and the under-supply (*i.e.*, under-connected) to obtain its entire demand from its own wells, thus doing away with this prospective purchaser and seller among the purchasers. This just is not proration. To allow one purchaser to obtain more than its fair share of the reserves from its own connections in a common source of supply by virtue of a gas conservation act enacted by any state is unlawful. The state, if it desires to pass a gas conservation act, must do so with the legitimate aim of preventing waste and protecting correlative rights. If its order does not reasonably achieve these ends, it is outside the state ambit. This Court so determined in *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55, 57 S. Ct. 364, 81 L. Ed. 510 (1937).

Under the orders herein a purchasing company is given a state license to divert reserves of another pipe line purchaser with a lesser demand to itself, unless such pipe line purchaser with the lesser demand, having been denied the opportunity to sell its underage within the Field, changes its purchasing patterns and protects itself by taking proportionately the same quantity of gas from the Kansas Hugoton Field as the pipe line purchaser with the greatest demand.

It is no answer to suggest, as the Federal Power Commission does, that the state does not have to pass any gas conservation act at all. Without such an act, the rule of capture prevails and anyone may produce whatever he can obtain through his own wellbore. The only protection others have is the right of self-protection, *i.e.*, to obtain all they can produce through their own wellbores. The point is that although the state does not have to pass any gas conservation act, if it does, it must pass one that meets the standards prescribed by our Constitution and our fed-

eral laws. Such Constitution and laws prescribe that the state is without authority in the field of gas except to deal with production and gathering as exempted from the Natural Gas Act and to deal in this area only reasonably to prevent waste and to protect correlative rights. Herein our problems concern the volumes of purchases, which do not fall within the exception. Herein the state act as carried forward in instant orders does not deal with proration and therefore is beyond the state's authority. Therefore, whether looked upon on one side or the other of the coin, the orders herein must fail as violative of the federal Constitution and laws.

Admittedly, there is drainage within the Kansas Hugoton Field and such drainage is toward the producer taking more than its share of the gas reserves. Such result cannot lawfully obtain as not *Thompson* v. *Consolidated Gas Utilities Corp., supra.* This Court in *Northern, supra,* determined that Kansas could not with a ratable take order seek to increase the gas purchases in the Kansas Hugoton Field. In commenting thereon, Meyers, in 77 *Harvard Law Review*, 689, at 699, observed

> "That the Natural Gas Act forbids state action seeking to increase its share of the market at the expense of other states is a tenable and much narrower proposition than that (or those) discernible from the opinion as written. Indeed the commerce clause of the Constitution would seem to forbid such action by a state."

Seven years earlier Chief Judge Murrah of the United States Court of Appeals, Tenth Circuit, stated concerning the same question (albeit in relation to an order for oil rather than gas) in *Gulf Oil Corp.* v. *Corporation Commission of Oklahoma*, 147 F. Supp. 640, U.S.D.C., W.D. Okla. (1956) (in a three judge proceeding where the ma-

jority invoked the doctrine of abstention), where Oklahoma sought to increase Gulf's oil purchases in Oklahoma, 147 F. Supp. at 649,

> "* * * The net result of all of this is a coercive, even though laudable, attempt to preserve Oklahoma's market for its crude oil in competition with other states. The undisputed evidence is that if Gulf is required to take the full allowable, it must do one or all of four things. First, it may withdraw completely from the state with obvious disastrous consequences; second, reduce the number of leases from which it purchases in Oklahoma; third, it may curtail its repurchases of Oklahoma crude with consequent adverse impact upon free interstate trade in oil; or, fourth, it may curtail its interstate purchases elsewhere in order to accommodate the purchase of Oklahoma allowables. To me, any alternative is to impose a restriction upon interstate commerce for the economic advantage of the State of Oklahoma. If Oklahoma can enforce its order to take more oil for interstate markets than the market demand therefor, other competing states can do likewise with chaotic and disruptive consequences to interstate commerce."

III.

It is suggested by the Federal Power Commission that the federal question herein presented is not substantial since no pipe line purchaser is yet hurt. This is a surprising assertion since if the pipe line purchasers waited and acquiesced in the orders of the Kansas Commission until they actually had lost a portion of their reserves dedicated to their interstate markets, they would, in all likelihood, have waived any right to complain. We take it, however, that the real thrust of the Federal Power Commission's contention is that the Kansas State Corporation Commission has entered a moratorium for a year in can-

celing underages. This moratorium was indeed ordered by the Kansas Commission upon a showing that such underage could reasonably be run within such one year period. In fact the Commission has presently determined to look again and see if the moratorium should not be increased for an additional year. The moratorium is not substantive. It does not run any gas. It only postpones the time when reserves will be lost by one pipe line purchaser and such reserves transmitted to the consumers of another pipe line purchaser. Indeed so long as the Kansas Commission determines how much gas should be marketed from the Kansas Hugoton Field, *i.e.*, so long as it determines the volumes to be purchased and allocates this figure to the wells in the field, as it has been, and is now, doing, the underages which have developed cannot be run. This is inescapably so since the gas available for production under the Commission's current formula is more than will be marketed and there is no room left in either pipe lines or markets to run the vast accumulated underages which have increased, since the record that is bfore this Court was made, to well in excess of 275,000,000,000 cubic feet.

The federal question which we submit is substantial now prevails. The orders of which we complain seek to set volumes of purchases. Under such ordefs a pipe line purchaser's only method for holding onto its dedicated reserves for its own consumers is to change its purchasing patterns and match proportionately the production from the Kansas Hugoton Field of the purchaser with the greatest demand therefrom. This disrupts the purchasing patterns, disrupts the balance of Colorado Interstate in the BTU content of its gas, disrupts its plans and its price structure—all necessarily so. No moratorium can erase this reality. The problem is real, the problem is now.

IV.

Lastly, the Federal Power Commission urges that as to this Appellant, which has the only take or pay for contracts in the Kansas Hugoton Field, there is some other magic remedy to offset the loss of reserves, the tampering with purchasing patterns, and the complexities upon which price must be based. It suggests that the leverage of the present orders of the Commission on Colorado Interstate because of its take or pay for contracts can be eliminated by virtue of a proceeding before the Federal Power Commission under Sec. 5A of the *Natural Gas Act*, 15 U.S.C. 717d(a), to reform such contracts and remove the take or pay for provisions.*

There has never been such a proceeding. There is nothing in the statute which even suggests such a possibility. How such position can be advocated by the Federal Power Commission when it is so far out, so far reach-

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*§ 717d. Fixing rates and charges; determination of cost of production or transportation.

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance wth a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rate.

ing and entails so much stretch, at the same time and in the same memorandum where it can not recognize a very direct encroachment upon its responsibilities is beyond us. Neither the Federal Power Commission nor this Court conjured up such a remedy in *Northern*, *supra*. This Court there found a contractual provision with the alternatives available to a pipe line purchaser sufficient to invoke its appellate jurisdiction, stating, 372 U.S. at 89,

> "* * * These orders presented the appellant with the alternatives of complying with the obligations of the Republic contract and increasing its takes from the other producers' wells—thus taking more gas from Kansas than it could currently use—or of risking liability for a breach of the Republic contract by decreasing its takes from the Republic wells below the allowables."

We submit that the arguments advanced by the Federal Power Commission to support its assertion that our federal questions are not substantial, are transparent, fallacious and illogical. We have examined them one by one and have demonstrated that our federal questions are indeed substantial, are real, and require the action of this Court.

Respectfully submitted,

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